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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 148

MARINE NATIONAL EXCHANGE BANK OF MILWAUKEE AND WEST SIDE BANK,

Petitioners and Appellants below,

VS.

KALT-ZIMMERS MANUFACTURING COMPANY AND M. H. GROSSMAN, Trustee in Bankruptcy,

Respondents and Appellees below.

RESPONDENT'S BRIEF on WRIT of CERTIORARI

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SUPREME COURT OF THE UNITED STATES

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MARINE NATIONAL EXCHANGE BANK OF MILWAUKEE AND WEST SIDE BANK,

Petitioners and Appellants below,

vs.

KALT-ZIMMERS MANUFACTURING COMPANY AND M. H. GROSSMAN, Trustee in Bankruptcy,

Respondents and Appellees below.

RESPONDENT'S BRIEF on WRIT of CERTIORARI

The Circuit Court of Appeals for the 7th Circuit decided the matter on April 18, 1934 (R. 103). The case is on a writ of certiorari granted October 8, 1934. The petitioners claim that this court has jurisdiction because the court of appeals has construed Section 116.61 of the Wisconsin statutes of 1929 contrary to a prior interpretation by the Supreme Court of Wisconsin. The opinion of the District Court of the United States for the Eastern District of Wisconsin is found on pages 77 to 79 of the Transcript, 6 Fed. Suppl. 638. The opinion of the court of appeals is found at 70 Fed. 2d 815 (R. 95-102).

STATEMENT OF THE CASE

Respondent issued its bonds (R. 66). They bear the heading "Six Per Cent Refunding First Mortgage Serial

Gold Bond." They provided that the interest and principal should be payable at the office of Hackett, Hoff & Thiermann, Inc., Milwaukee, Wisconsin, trustee. They recited that the bond was one of a series authorized and issued by the respondent, known as "Six Per Cent Refunding First Mortgage Serial Gold Bond" and— * * * "Said bonds are issued under and secured by a mortgage or deed of trust of even date herewith, duly made, acknowledged and delivered by said Kalt-Zimmers Manufacturing Company to Hackett, Hoff & Thiermann, Incorporated, Trustee, to which deed of trust reference is hereby made with the same effect as though recited at length herein, for the description of the property mortgaged, the nature and extent of the security, the rights of the holders of the bonds, and the terms and conditions upon which the said bonds are issued, held and secured, and may, before their fixed maturities, be declared at once due and payable, and the manner of prepayment before maturity." (R. 67).

The bonds also provide that they may be paid prior to maturity at the option of the respondent with a premium of one per cent as provided by the trust deed and that the entire principal becomes due in case of any default in the performance of the terms of the trust deed. The bond also says:

> "This bond shall not be valid for any purpose or be secured by the said deed of trust unless and until the certificate hereon endorsed be executed by the Trustee under said deed of trust." (R. 67-68).

The bond bears a certificate: "This is to certify that this bond is one of the bonds mentioned in the mortgage or trust deed referred to within. Hackett, Hoff & Thiermann, Incorporated, Trustee, By (Signature illegible) Secretary." Also: "(Notice: No writing on this bond

except by Hackett, Hoff & Thiermann, Incorporated, Trustee, or its successor in trust)" (R. 68).

The portions of the trust deed referred to by the bond read, as follows: (R. 34, 35)

> "(1) It is hereby understood and agreed that said issue of One Hundred Fifteen Thousand Dollars ($115,000.00) of bonds, hereby provided for, shall, upon the signing and execution hereof, or as soon after as practicable, be duly certified by the Trustee and negotiated and sold by the Trustee; and said Trustee shall first set aside sufficient bonds or the proceeds of sufficient bonds to pay off that certain trust deed or mortgage in the principal sum of Fifty-five Thousand Dollars ($55,000.00), hereinafter described; the balance of said proceeds of said bonds, so sold, shall then be disbursed by said Trustee as hereinafter provided.".
>
> * * *
>
> "WHEREAS, there is an encumbrance existing against the premises above described, evidenced by a mortgage or deed of trust in the principal sum of Fifty-five Thousand Dollars ($55,000.00), dated the first day of January, 1923, recorded in the office of the Register of Deeds of Milwaukee County, Wisconsin, on the second day of January, 1923, in Volume 1087 of Mortgages, page 36, Document No. 1184879, and on which trust deed or mortgage there is unpaid a balance of principal of Thirty-five Thousand Dollars ($35,000.00);
>
> "NOW, THEREFORE, IT IS AGREED, that said Trustee first set aside and hold a sufficient number of bonds or the proceeds of a sufficient number of bonds to fully pay and satisfy, as soon as it can be done, the above mortgage in the principal sum of Fifty-five Thousand Dollars ($55,000.00); and after so setting aside such sufficient number of bonds or the proceeds of a sufficient number of bonds for the above purpose of paying and satisfying the above mortgage, the pro-

ceeds of the balance and remainder of said bonds shall then be paid out in liquidation of the cost of the contemplated building in course of erection or to be erected on said premises, upon architect's certificates issued from time to time for completed construction to date of such architect's certificates, and if any balance remains after the completion and full payment of said building, the balance is then to be at the disposal of the party of the first part."

The trust deed also contains a provision (R. 37):

"(6) The Trustee or any of its officers, agents, or stockholders may acquire, own and deal in said bonds and coupons with the same rights as if not Trustee hereunder and shall not be obliged to account to anyone for any profits made thereby."

Bonds held for the purpose of refunding the prior mortgage according to the trust deed were embezzled by Hackett, Hoff & Thiermann, Incorporated, and accepted by the petitioners as security for the personal loans of the trustee. In most cases they were taken as substitutions of collateral on old loans, but in one case apparently as collateral for a new loan. (R. 27-33).

SUMMARY OF THE ARGUMENT

I. The language on the face of the bond and the nature of the pledge gave the bank actual notice of the breach of trust.

II. The references in the bond make the part of the trust deed by which the trust is created a part of the bond and show that the trustee had no power to pledge the bond for his own debt .

III. Negotiable Instruments Law does not change the rule that a holder who took the bond with notice of

facts which showed a breach of trust is not a holder in due course.

IV. The question of notice has not been passed on by the Wisconsin court.

ARGUMENT

We will not discuss in this brief the question which is not decided by either of the courts below and which we do not consider material, as to whether or not the bonds in suit were negotiable instruments. The respondents have always maintained that that question was immaterial and that the case turned on whether or not the banks in accepting bonds for pledge as collateral to the personal loans of the trustees became a *bona fide* holder in due course.

I.

THE LANGUAGE ON THE FACE OF THE BOND AND THE NATURE OF THE PLEDGE GAVE THE BANK ACTUAL NOTICE OF THE BREACH OF TRUST

The bond provided that it is to be effective when signed by Hackett, Hoff & Thiermann, Incorporated, as trustee; that the principal and interest are payable to the trustee; that real estate has been transferred to them as trustees for the security of the bonds. They certify to the bond as trustee. From the face of the bond itself, then, it clearly appears that Hackett, Hoff & Thiermann, Inc., had a trust to perform in relation to the transaction between the bondholder and the principal. No authority is given by the bond for Hackett, Hoff & Thiermann to become personally interested in that transaction. They were trustees for both the owner and the bondholder.

They owed the duty of maintaining the utmost impartiality between them and to perform their duties with strict regard to the rights of each.

Schroeder v. Arcade Theater Co., 175 Wis. 79.

The court said on page 103:

> "The trustee, under the provisions of the trust deed, in some respects represents the bondholders, in other respects the mortgagor, and in still other respects both bondholders and mortgagor."

And again, on page 106:

> "The delicate position in which a trustee, therefore, is placed by the trust deed, in and by which he is required and obligated to act in a dual capacity, also becomes clear, and in the execution of his obligations and powers under the law it is incumbent upon him to use the utmost good faith towards all parties in interest. He must act impartially for every person who has any rights in the estate. 2 Perry, Trusts, Sec. 602o."

Bell v. Scranton Trust Co., 282 Pa. 562, 128 Atl. 494;

Ainsa v. Mercantile Trust Co., 174 Calif. 504, 163 Pac. 898.

They could not place themselves in the position of one of their *cestuis que trustent* without a violation of their duty to their other *cestuis que trustent* and they were clearly disqualified to deal in the subject of the trust and had no right whatever to become personally interested in the bonds.

Holman v. Ryon, 56 F. (2d) 307;

Spruill v. Ballard, 58 F. (2d) 517.

Everyone who deals with the trustee is conclusively presumed to know that this is the law and when the

bank accepted the bonds from Hackett, Hoff & Thiermann they knew that they did so at their peril and that in offering them for pledge for their own account Hackett, Hoff & Thiermann was breaching its trust.

In *Wormley v. Wormley,* 8 Wheat. (U.S.) 421, 445, the court said:

> "The next point for consideration is, whether the defendants, Veitch, and Castleman and M'Cormick were *bona fide* purchasers of the Frederick lands, without notice of the breach of trust. If they had notice of the facts, they are necessarily affected with notice of the law operating upon those facts; and their general denial of all knowledge of fraud, will not help them, if, in point of law, the transaction is repudicated [repudiated] by a court of equity."

In *United States v. Dunn,* 268 U. S. 121, 131:

> * * * "It is not necessary in such a situation in order to establish the right to relief to show that the beneficiary was damaged by the fraudulent conduct of the trustee. It is sufficient to establish that the fiduciary has exercised his power of disposition for his own benefit without more."

In *Duncan v. Jaudon,* 15 Wall. 165, 175, shares of stock had been taken by banks as security for the personal debt of the trustee. The court says (page 175):

> "It follows, then, that the use of the stocks by Jaudon in his transactions with the bank and Duncan, Sherman & Co. was, on his part, a flagrant breach of trust, without either justification or excuse. If so, are they blameless? They cannot be, if they had actual or constructive notice that the trustee was abusing his trust and applying the proceeds of the loans to his own use. As we have seen, the loans were for no purpose connected with the trust, but for Jaudon's own benefit, and the face of the papers given as collateral security for the debts thus in-

curred informed the parties dealing with him that he held the stock as trustee for Mrs. Mary T. B. Jaudon, and inquiry would have revealed the fact that the use to which the stock was put was unauthorized.

"The duty of making such inquiry was imposed on these parties, *for it is out of the common course of business to take corporate stock held in trust, as security for the trustee's own debt.* The party taking such stock on pledge deals with it at his peril, for there is no presumption of a right to sell it, as there is in the case of an executor. In the former case the property is held for custody, in the latter for administration." (Italics ours).

To the same effect is *Brovan v. Kyle,* 166 Wis. 347, 352; *Whitford v. Moehlenpah,* 196 Wis. 10, 24; *Sternfels v. Watson,* 139 Fed. 505, 507-508; *Jenkins v. Planters' & Mechanics' Bank,* 34 Okla. 607, 126 Pac. 757; *Keisel v. Baldock,* (Okla.) 154 Pac. 1194; *Huches & Co. v. Flint,* 61 Wash. 460, 112 Pac. 633.

That this breach of trust existed was a matter of actual knowledge to the bank for all that was necessary was to examine the face of the bond to see that Hackett, Hoff & Thiermann was a trustee, on whose signature the validity of the bond depended, and to whom the bond was payable, in order to know that in offering it for pledge Hackett, Hoff & Thiermann were violating their trust. On the bond alone it is apparent that the bank took the bond with actual knowledge of the infirmity of the title of Hackett, Hoff & Thiermann.

II.

THE REFERENCES IN THE BOND MAKE THE PART OF THE TRUST DEED BY WHICH THE TRUST IS CREATED A PART OF THE BOND

The trust deed is referred to with the same effect "as though recited at length" in the bond for two purposes, first for a description of the property mortgaged, and the nature and extent of the security and rights of the holders of the bonds. No question of security is here involved. But the trust deed is also referred to as though recited at length for the terms and conditions upon which the bonds are issued, held, and secured, and may before their fixed maturities be declared at once due and payable and the manner of prepayment before maturity. This part of the bond cannot be read with reference to the security alone for if it is so read it is surplusage. It means just what it says and incorporates in the bonds the terms of the trust deed under which *the bonds* are issued and held. Those provisions are that the bonds are to be issued in trust to the trustees and held by them for the purpose of refunding prior issues and improving a building on the premises. Counsel cites no cases to the effect that this incorporation is ineffective. In the section of his brief as to negotiability he cites cases dealing with references to the trust deeds for the purposes of determining the security such as are contained in the first part of this sentence. None of them indicates that the references for the purpose of determining the rights of the bondholders is ineffective. In fact in the case of *Merchants National Bank v. Detroit Trust Company,* 258 Mich. 526, 242 N.W. 739, cited by him on page 19 of his brief where the language was "And

the terms and conditions upon which said bonds are secured and are to be used" the court says (p. 742):

> * * * "The language of the reference advises an investor that, in considering whether the purchase of these bonds is a safe investment, he may look to the conditions of the mortgage to learn the use which is to be made of the money received from their sale."

Of course if he must look to the terms of the trust deed to determine the use of the money he must look to it also to determine whether the proceeds are in trust or not. The distinction is well stated by the Michigan court in *Paepcke v. Paine,* 253 Mich. 636, 235 N.W. 871, 75 A.L.R. 1209, cited by the respondent. The court said:

> "There is a clear distinction between this reference and that contained in Allen v. Moline Plow Co. (C.C.A.) 14 F. (2d) 912, and Crosthwaite v. Moline Plow Co. (D.C.) 298 F. 466, 468, relied on by plaintiff, where there was reference to a trust agreement 'for a description of the terms under which the said notes are issued, and of the rights and obligations of the company and the trustee with respect thereto.' Under this reference the trust instrument must be examined to determine the rights and obligations of the company under the notes; in that before us it applies only to the rights and obligations under the trust agreement."

It is perfectly evident that if the bank read the portions of the trust deed which referred to the conditions under which these bonds were issued and held they knew of the existence of the trust. They were required to take notice of what was in the trust deed. It is said in *Pringle v. Dunn,* 37 Wis. 449, 466:

> "That where a purchaser cannot make out a title but by a deed which leads him to another fact, he will be presumed to have knowledge of that fact."

In *Reichert v. Neuser,* 93 Wis. 513, 515-518, it is held that where a warranty deed excepts "a certain mortgage for $900," all those claiming under the deed are chargeable with notice of the mortgage and their rights are subject to the mortgage.

The bank was bound to look at the trust deed to see what were the terms of its contract. One who takes documents from which the trust appears or which refer to documents from which the trust appears are not innocent purchasers.

In *Graff v. Castleman,* 5 Randolph, 195, 16 Am. Dec. 741, 751, the court said:

> "The deed of assignment refers to the deed of trust as a part of itself. The deed of trust refers expressly to the original deed, and that as expressly to the will of Dr. Orr, where the whole trust is declared. Of this trust, then, Graff had full notice, and knew that by the trade, the executor was committing a gross breach of trust. He was a party to that breach, 'by paying his money to this private trade of the executor.'"

In *Young v. Weed,* et al, 154 Pa. 316, 26 Atl. 420, 422, the court says:

> "The deed to appellants refers to the will of F. R. Weed, deceased, and recites fully the trust therein created. The appellants, therefore, are not purchasers without notice, but were put upon inquiry, and had full notice. It is said in *Garrard v. Railroad Co.,* 29 Pa. St. 158: 'Where a purchaser cannot make out a title but by a deed which leads him to another fact, he shall be presumed to have knowledge of that fact. So, he is supposed to have knowledge of the instrument under which the party with whom he contracts as executor, or trustee, or appointee, derives his power.' As the appellants

> are not purchasers for a valuable consideration, and took the property with full notice, equity will follow it into their hands. *Petrie v. Clark,* 11 Serg. & R. 377."

None of the cases cited by the petitioner hold that the terms of the trust agreement are not effectively imported into the bond by such language as is used here. They merely hold that the terms imported into the agreement do not affect its negotiability. We are not concerned with negotiability in this case. We are simply concerned with the notice brought by the incorporation of the trust deed into the bond of the terms of the trust under which Hackett, Hoff & Thiermann had the bonds. It cannot be claimed that this has not been accomplished. It has always been held that one document may refer to another and incorporate its terms and that where this is done it becomes a part of it. In *Allen v. Moline Plow Co.,* 14 F. 2d 912, an agreement in the trust limiting the right of a note holder to sue on a note was held to be incorporated into the note by the words "to which agreement reference is hereby made for a description of the terms under which the said notes are issued and of the rights and obligations of the company and the trustee with respect thereto." *Crosthwaite v. Moline Plow Co.,* (D.C.N.Y.) 298 F. 466, 468, and cases there cited.

The bank seeks to justify their action in taking these bonds because the trust deed gives to Hackett, Hoff & Thiermann the right to buy and sell the bonds. This right in itself gave no power to Hackett, Hoff & Thiermann to pledge the bonds.

> *Shaw v. Saranac Horsenail Co.,* 144 N.Y. 220, 39 N.E. 73, 74.
>
> *Loring v. Brodie,* 134 Mass. 453.

Tuttle v. First National Bank, 187 Mass. 533, 73 N.E. 560.

First National Bank v. Natl. Broadway Bank, 156 N.Y. 459, 51 N.E. 398, 401.

Greene v. Greene, 19 R.I. 619, 35 Atl. 1042, 1045.

Colonial Trust Co. v. Brown, 105 Conn. 261, 135 Atl. 555, 564.

Sanger v. Farnham, 220 Mass. 34, 107 N.E. 359, 360.

Townsend v. Wilson, 77 Conn. 411, 59 Atl. 417, 419.

Still the bank claims that they may look to the trust deed to rebut the presumption of illegality and read that part of the trust deed which allows the trustee to sell the bonds and ignore the fact that the pledge of the bonds for the personal benefit of the trustee was not authorized. If the trust deed is not referred to, the bank's action in taking the bonds in pledge for the debt of the trustee is not lawful, because the trustee was forbidden to deal with the bonds at all, there being no language in the bond which relieved him of his duties as trustee. If the trust deed is referred to, the bank must read the powers actually written in it, which do not include the power to pledge the bonds. However, if we assume that, on the face of the bond, the trustee had a right to deal in them, still the references to the trust deed, made by the bond, are sufficient to show bad faith on the part of the bank.

III.

THE NEGOTIABLE INSTRUMENTS LAW DOES NOT CHANGE THE RULE

The petitioners claim that the Negotiable Instruments Act in effect in Wisconsin has changed these rules as to trustees. This act provides—"To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same the person to whom it is negotiated must have had actual knowledge of the infirmity or defect or knowledge of such facts that his action in taking the instrument amounted to bad faith." Sec. 116.61, Wis. stats. 1929.

This section is quoted by the petitioner but it is not the only section which relates to a holder in due course. Section 116.57 provides that a holder in due course is a holder who has taken the instrument under the following circumstances: * * * "(3) that he took it in good faith and for value; (4) that at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it, (5) that he took it in the usual course of business."

To take securities held in trust in pledge for the personal debt of the trustee is not a transaction in the usual course of business. See cases heretofore cited. The bank had actual notice of what appeared on the face of the bond. There was nothing constructive about that. It could not even determine whether the instrument was negotiable without reading it and certainly it cannot be heard to say that it did not know that Hackett, Hoff & Thiermann was a trustee. It had actual knowledge that the bonds were being pledged by Hackett, Hoff & Thiermann for their own account. It cannot be heard to say that it did

not know why it received the bonds or was in any doubt as to the purpose for which they were received. It had actual knowledge of the law, that a trustee cannot deal in the subject of his trust. These are the only facts which are required to show that the title of the pledgor of these securities was defective.

It is argued that it might possibly have happened that the securities had passed out of the trust to a *bona fide* purchaser and that the trustee had acquired them in due course and had a right to pledge them under the terms of the trust deed. This is an affirmative defense to the apparent fraud.

The parts of the deed referred to in the bond would clearly show the bank that the bonds and their proceeds were held under a specific trust by the trustees. On the facts, which the bank knew at the time of the transaction, the title of the trustees to the bond was defective. They have no right to guess that an independent transaction had occurred of which they had no evidence. Any investigation which they carried on would not be for the purpose of showing that the title was defective but for the purpose of showing that it was not defective, and to accept the bonds without making such investigation was to accept them with knowledge of such facts as show bad faith. One who knows facts which show that property is stolen or embezzled should not be held to be acting in good faith in accepting it because he assumes without knowledge or evidence that there may be other facts which constitute a defense to the established case of wrong.

In *Owens v. Nagel,* 334 Ill. 96, 165 N.E. 165, suit was brought on a promissory note. Defendant purchased stock in the corporation under an agreement

whereby he paid $500.00 in cash and executed his promissory note for $1500.00 to the president of the corporation, who was not to transfer it to the corporation until such corporation had paid its debt to the defendant. In violation of this agreement the president transferred the note to the plaintiff. The note was executed to the president of the corporation as trustee.

The court said on page 167:

> * * * "Section 56 (Smith-Hurd Rev. St. 1927, c. 98, Sec. 76) provides that to constitute notice of an infirmity or defect in the title of a person negotiating the note the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.
>
> "(2, 3) Plaintiff in error insists that, because the note was payable to Erisman, trustee, the word 'trustee' was a warning to all purchasers that Erisman held it in a fiduciary capacity, and that all purchasers were put upon inquiry and were charged with such notice as inquiry would have revealed. A negotiable instrument made in favor of A. B, trustee, is none the less negotiable, and a purchaser thereof from the trustee is not charged with or subject to equities existing in favor of the makers when the trustee, in disposing of the note, did not act in contravention of his trust. The great weight of authority, as well as the better reasoning, favors the rule that the word 'trustee,' when appended to the name of the payee of a bill or note, is sufficient to charge a purchaser with notice of restrictions and limitations imposed on the trustee's power to dispose of the instrument. The term is a warning and a declaration to every one who reads it that the person so named is not the owner of the property to which it related, that he holds it for the use and benefit of another, and that he has no right or power to sell or dispose of it

except in accordance with the terms of the trust. A trustee has no authority to transfer trust funds in payment of his private debt, and an attempt to do so constitutes an illegal diversion of the trust property. The fact that the word 'trustee' is on the face of the note does not put the purchaser to any inquiry beyond ascertaining whether the trustee has power to sell or otherwise dispose of it."

And again on 168:

* * * "Where a note is payable to a trustee, one who purchases from the payee in settlement of an individual debt of the payee is by the terms of the note put on inquiry as to the character and limitation of the trust, and, if he accepts the note without such inquiry, he does so at his peril."

In *Fehr v. Campbell,* 288 Pa. 549, 137 Atl. 113, a note endorsed to a corporation was used by its president in payment of a personal debt.

The court said on pages 115-116:

"(3, 4) Prima facie, an officer of a corporation has no authority to use its funds or securities to pay his private obligations or as collateral for his personal loans, and it is well settled that one who takes negotiable paper which appears to be, or which the taker knows to be, the property of a corporation, for the purpose of applying such paper to the personal use of one of the officers of such corporation, or of a third party, is bound to inquire as to the authority of the officer to make such use of the paper, and if no inquiry be made, the taker is held as though he had knowledge of all that inquiry would have revealed. Finally, if it is not affirmatively shown that inquiry would have revealed facts sufficient to overcome the prima facie misappropriation, the presumption of bad faith remains."

The court said on page 119:

"* * * Again, plaintiff took the note under circumstances which in law charge him with knowledge of, and participation in, a direct act of bad faith on the part of Stein, for he (Fehr) actually assisted Stein to appropriate $1,700 of the note as his own property by enabling him to use the paper to that extent in payment of his personal debts. Therefore, under Section 55 and 56 of the Negotiable Instruments Act, Fehr accepted the instrument in suit with knowledge of a defect in the title of a person who negotiated it to him, and is barred on that ground from claiming the rights of a holder in due course."

Ford v. Brown, 114 Tenn. 467, 88 S.W. 1036.

Gilman v. F. O. Bailey Carriage Co., 125 Me. 108, 131 Atl. 138.

First Nat. Bank v. National Broadway Bank, 156 N.Y. 459, 51 N.E. 398.

Fidelity & Deposit Co. v. Queens County Trust Co., 226 N.Y. 225, 123 N.E. 370.

Hall v. Windsor Savings Bank, 97 Vt. 125, 121 Atl. 582.

Pelton v. Spider Lake S. & L. Co., 132 Wis. 219.

Wisconsin Yearly Meeting v. Babler, 115 Wis. 289.

Ward v. City Trust Co., 192 N.Y. 61, 84 N.E. 585.

IV.

THE QUESTION OF NOTICE HAS NOT BEEN PASSED ON BY THE WISCONSIN COURT

Counsel claims that the case of *Pollard v. Tobin,* 211 Wis. 405, is conclusive on this case, and he arrives at that conclusion by saying that facts in that case, had they been

properly presented to the court and the point raised that the banks had knowledge of such facts as to show the defect in title, would have sustained a defense to the bonds. This point was not actually decided in the *Pollard* case.

The Supreme Court of Wisconsin is not bound by decisions where a point might have defeated the action had it been raised but was not raised. This is particularly true in the construction of statutes. In *State ex rel. Sheboygan v. Sheboygan County,* 194 Wis. 456 the question arose as to whether a city had the power to bring a certain action under the statutes defining the powers of the common council. The court says on page 459:

> "The relators cannot rely upon the fact that similar actions have been maintained in which the right of the municipality to prosecute such actions was not questioned, because the question now under consideration was neither raised nor considered in those cases. Such decisions are not authority either way upon this question. The right of a municipality to maintain *certiorari* in such tax matters was questioned nearly fifty years ago, but not decided at that time."

The same rule has been applied in this court to the construction of statutes by state courts. Such construction by implication where the point was not raised is not binding on the United States courts.

Kuhn v. Fairmont Coal Co., 215 U.S. 349, 360:

> " * * * 4. So, when contracts and transactions are entered into and rights have accrued under a particular state of the local decisions, *or when there has been no decision by the state court on the particular question involved,* then the Federal courts properly claim the right to give effect to their own judgment as to what is the law of the state applic-

able to the case, even where a different view has been expressed by the state court after the rights of parties accrued. But even in such cases, for the sake of comity and to avoid confusion, the Federal court should always lean to an agreement with the state court if the question is balanced with doubt."

Risty v. Chicago R. I. & Pac. Ry. Co., 270 U.S. 378, 387:

"While there are expressions in the opinion in Gilseth v. Risty, 46 S.D. 374, decided after these suits were begun, which, standing by themselves, might be regarded as supporting the view that the proceedings now in question were authorized by the statutes of South Dakota, the court clearly rested its decision upon other grounds. It is the duty of the federal courts, in suits brought in or removed to the district courts, to decide for themselves all relevant questions of state law, and while they will follow the decisions of state courts as to the interpretation of a state statute, we do not think that the case of Gilseth v. Risty, supra, so clearly or decisively passed upon the question here involved as to control our decision."

Farmers Bank v. Federal Reserve Bank, 262 U.S. 649.

Pacific Co. v. Johnson, 285 U.S. 480.

Graham v. Englemann, 263 Fed. 166, 168.

Knight v. Shelton, 134 Fed. 423, 436-437:

"The declarations in favor of the validity of these amendments alleged to have been made by the Supreme Court are claimed to be found in the opinions of that court in Dunn v. Lott, 67 Ark. 591, 58 S.W. 375, and Childers v. Duvall, 69 Ark. 336, 63 S.W. 802; the first case confirming, it is claimed, the validity of amendment No. 2, and the last case that of amendment No. 3. But neither the reports of these cases nor the original records thereof, including the

briefs of counsel, which the court has carefully examined, show that these questions were either raised, argued by counsel, or in any manner, directly or indirectly, brought to the attention of the court in either of the cases. Under such circumstances, to contend that these cases are decisions of the court on that subject is against all reason, and without any authority. The rule of stare decisis has been often before the courts and none of them has ever carried it to the extent now claimed by counsel for the defendants."

* * *

If the rule were otherwise the mistakes and omissions of counsel in the state courts would fix the law of the land through the decisions of this court.

The Circuit Court of Appeals has discussed and severely criticized the opinion in the *Pollard* case on the question of the negotiability of the instruments in question. The conclusion arrived at by the Wisconsin court does seem strange, but we are not concerned with the question of negotiability. The trust deed contained the power in the trustees to sell the bonds and apply their proceeds to the redemption of the outstanding mortgage. If the bank had bought these bonds from these trustees in good faith, whether they are negotiable or not they are good in the hands of the bank. It seems, however, that the pledge of the bonds to the personal obligation of the trustee, contrary to the terms of their trust, precludes the idea of good faith on the part of the bank and they cannot hold the bonds either way.

It is respectfully submitted that the judgment of the Circuit Court of Appeals for the 7th Circuit should be affirmed.

Respectfully submitted,

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Counsel for the Respondent.